STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY	)	Docket No. 03-0008
UNION ELECTRIC COMPANY	)	Docket No. 03-0009
	)	Consolidated
Proposed General Increase	)	
in Natural Gas Rates	)	

REBUTTAL TESTIMONY

SUBMITTED BY

DAVID J. EFFRON

ON BEHALF OF

THE PEOPLE OF THE STATE OF ILLINOIS

JUNE 5, 2003

AG Exhibit 1.1

Q. Please state your name.

A. My name is David J. Effron.

Q. Have you previously submitted testimony in these dockets?

A. Yes. I submitted direct testimony in each docket on April 2, 2003, marked as AG Exhibit 1.0. My qualifications and experience are included with that direct testimony.

Q. What is the purpose of this rebuttal testimony?

A. In this rebuttal testimony, I respond to the rebuttal testimony of witnesses Subbakrishna, Karman, and Opich on behalf of Central Illinois Public Service Company ("CIPS") and Union Electric Company ("UE"), together "the Companies."

Q. On Page 7 of AmerenCIPS/UE Exhibit 17, Witness Subbakrishna states that he agrees in part with your proposed adjustment to the lag in PGA revenue and then goes on to present a revised calculation of the lag applicable to PGA revenue. Does the revised calculation resolve this issue?

A. No. The revised calculation separates the PGA revenue into a true-up component and a residual component that is equal to the total PGA revenue minus the true-up component. The residual component is assigned a lag equal to the lag for base rate revenue, 41.45 days for CIPS and 40.16 days for UE, as I proposed. The true-up component is assigned a lag of approximately 61 days. A revised lag for PGA revenue was calculated based on the relative weighting of these two components for the twelve months ended June 30, 2002.

The lag of approximately 61 days assigned to the true-up component appears to be accurate. However, the true-up component itself can be negative as well as positive. If the true-up is positive, then the weighted average lag for the total PGA revenue will be greater than base rate revenue lag; but if the true-up is negative, then the weighted average lag for the total PGA revenue will be less than base rate revenue lag.

During the test year the true-up happened to be positive overall, but unless there is some bias in the determination of the PGA factor, then it is just as likely that the true-up for any given period will be negative as that it will be positive. That is, the price of gas will fluctuate from month to month. Sometimes the true-up will reflect a temporary under-recovery and sometimes it will reflect a temporary over-recovery. If the true-up had been negative in the test year, as it will be from time to time, then the weighted PGA revenue lag would have been less than the base rate revenue lag.

Mr. Subbakrishna has not established that there is any bias in the determination of the PGA factor that would cause a positive true-up to be more likely than a negative true-up. Therefore, I believe that it is reasonable to assume that over time the positive and negative true-ups should balance out. Using the formulation in AmerenCIPS/UE Exhibit 17.2, this results in a zero weighting for the true-up and a lag for PGA revenue that is equal to the lag for base rate revenue, as I recommended in my direct testimony.

Q. Witness Karman takes exception to Staff's use of a "5-year average of uncollectible expense." Is her characterization of Staff's method of calculating uncollectible accounts expense accurate?

A. No. Staff does not use a "5-year average of uncollectible expense." Rather, Staff has calculated the average ratio of uncollectible accounts expense to revenue and applied that ratio to test year revenue to determine the pro forma uncollectible accounts expense. Because the ratio is applied to all test year revenue, including PGA revenue, Staff's method properly takes account of the effect of the cost of gas on uncollectible accounts expense.

Q. On Pages 4-6 of AmerenCIPS/UE Exhibit No. 14.0, Witness Opich states his disagreement with your proposed adjustment to eliminate post-test year additions to plant from rate base. Do you have a response?

A. Yes. Mr. Opich notes that the Companies are authorized to use a historical test year or a future test year. There is no dispute on this point. However, I am unaware of any regulation that authorizes the Companies to mix and match a historical test year with a future test year to maximize its calculated revenue requirement. Yet that is just what Mr. Opich is proposing to do. That is, on the one hand, Mr. Opich is proposing to use a future test year for plant in service by adjusting plant for additions taking place after the test year. On the other hand, Mr. Opich is proposing to use a historic year for accumulated depreciation by not recognizing growth in the balance of accumulated depreciation taking place after the end of the test year.

Mr. Opich defends the adjustment for post-test year additions to plant on the grounds that these additions are known and measurable. The growth in the balance of accumulated depreciation is no less known and no less measurable. For example, in the case of CIPS, actual depreciation and amortization in the test year was $8,263,000. At that level, the accumulated reserve for depreciation and amortization will have grown by $8,263,000 (less the effect of any retirements and net cost of removal) from the end of the test year to June 30, 2003. This will more than likely offset the effect of any post-test year growth of plant in service. Mr. Opich fails to explain why it is appropriate to recognize the effect of known and measurable additions to plant in service but not appropriate to recognize the effect of equally known and measurable growth of the accumulated reserve for depreciation and amortization.

Q. Is Mr. Opich's assertion that your proposed adjustment will deprive the Companies of an opportunity to earn a return on actual plant additions that have been made since the filing of this case accurate?

A. Absolutely not. For CIPS, as of June 30, 2002, the end of the test year, the net plant in service was $153.5 million (prior to the allocation of common plant). This is the amount of net plant in service that I am proposing to include in rate base. As of December 31, 2002 the actual net plant in service was $153.6 million (response to Data Request AG 2.4), as the increase in the accumulated reserve for depreciation and amortization approximately offset the effect of plant additions through that date. That is, the growth in the accumulated reserve for depreciation and amortization, which is deducted from gross plant in the calculation of rate base, was approximately equal to the net additions to plant in service over the last six months of 2002. If history is any guide, increases in the depreciation reserve will continue to approximately match growth in plant additions over time, and the net plant in service balance in the future will not be materially different from the net plant in service at the end of the year. Including net plant in service as of the end of the test year gives CIPS a reasonable opportunity to earn a return on prospective net plant balances, including the effect of prospective plant additions.

Q. What about UE?

A. In my direct testimony, I recommended an alternative adjustment to net plant in service to recognize post-test year growth in plant. The statement by Mr. Opich that I merely proposed to exclude all capital additions placed in service after the June 30, 2003 test year is simply wrong. My proposed rate base does, in fact, recognize the effect of post-test year additions to plant in service. Unlike the adjustment proposed by Mr. Opich, it also recognizes the effect of growth in the accumulated reserve for depreciation and amortization.

Q. Do you contend that CIPS and UE will not be making plant additions after the end of the test year or that such additions will not be used and useful?

A. No. Of course the Companies will be adding plant after the test year. However, the Companies will also be retiring plant after the test year and will be recovering the cost of plant in service through the depreciation expense included in the cost of service. It would be internally inconsistent to recognize the effect on rate base of post-test year additions to plant in service without also recognizing the effect of post-test year increases in the accumulated reserve for depreciation.

Q. On Page 7 of AmerenCIPS/UE Exhibit No. 14.0, Mr. Opich criticizes your proposed adjustments to accumulated deferred income taxes ("ADIT"). Are his criticisms accurate?

A. No. Mr. Opich states that, "Mr. Effron only excludes certain deferred tax debit balances associated with items that are typically not considered in the determination of rate base." This assertion is incorrect. I did not "only exclude certain deferred tax debit balances." Reference to my Schedule B-2 (CIPS) clearly shows that I also excluded the deferred tax <u>credit</u> balance related to pensions. Contrary to Mr. Opich's testimony, I did, in fact, also take into account "deferred tax credit balances associated with items not considered in the determination of rate base." My adjustment is not "asymmetrical", as Mr. Opich alleges.

Q. Is Mr. Opich correct that the Commission has in the past rejected some proposals to adjust the balance of ADIT deducted from rate base?

A. Yes. However, as I pointed out in my direct testimony, the Commission has also accepted adjustments to eliminate certain deferred tax debit balances from the

ADIT deducted from rate base. I believe that it is also noteworthy that Central Illinois Light Company, an affiliate of CIPS and UE, is proposing in Docket No. 02-0837 to eliminate deferred tax credit balances related to gas site cleanup costs from the ADIT deducted from rate base. The decision to remove such balances of ADIT should not depend on whether removal increases or decreases rate base, but rather on whether their removal is consistent with the treatment of the items with which the ADIT are associated.

Q. Mr. Opich takes issue with Staff's treatment of PGA revenue and PGA expense on Page 10 of his rebuttal testimony. Do you agree with Mr. Opich?

A. Yes. Staff has included PGA revenue that is unequal to purchased gas expense in the determination of operating income for both CIPS and UE. As PGA rates are designed to recover purchased gas costs, Staff's treatment improperly distorts the calculation of adjusted operating income under present base rates for both Companies. The PGA revenue and purchased gas expense should both be excluded from the determination of operating income as proposed by Mr. Opich. As an alternative, it would not be improper to include PGA revenue and purchased gas expense in the calculation of operating income at equal amounts, so that their inclusion does not affect operating income.

Q. Do you have a response to Mr. Opich's rebuttal testimony on uncollectible accounts on Pages 10-11 of AmerenCIPS/UE Exhibit No. 14.0?

A. Yes. Staff has calculated pro forma uncollectible accounts expense by applying the normalized uncollectible accounts ratio to test year revenue, including PGA revenue for both CIPS and UE. Thus, contrary to Mr. Opich's implications, Staff properly took account of the effect of gas costs on uncollectible accounts expense.

I calculated pro forma uncollectible accounts expense for UE by applying the normalized ratio of write-offs to revenue to test year revenue, including PGA revenue. Thus, contrary to Mr. Opich's implications, I also explicitly recognized the effect of gas costs on uncollectible accounts expense for UE. With regard to CIPS, I noted in my direct testimony that applying the normalized write-off ratio to test year revenue would be a reasonable alternative to calculate pro forma uncollectible accounts expense, but would not produce a materially different result from the five-year average of uncollectible accounts expense that I used.

Q. Is Mr. Opich's proposal to amortize costs associated with the Voluntary Retirement Program ("VRP") over three years (AmerenCIPS/UE Exhibit No. 14.0, Page 13) reasonable?

A. No. Mr. Opich contends that the VRP put employees into pensions and other postretirement benefit plans only a few years earlier than they normally would have been. However, Mr. Opich does not state that the companies are saving only three years of salary for the retired employees by doing so, nor would this be a logical inference. It is my understanding that the purpose of the VRP was to save money. Yet, with the three-year amortization of costs proposed by Mr. Opich, the VRP expenses outweigh the VRP savings, and the VRP has the effect of increasing revenue requirements. If the VRP only saved three years' worth of salaries, on average, for the retiring employees, then based on Mr. Opich's calculations, the VRP was imprudent, as the savings were less than the costs. It is not reasonable to believe that the costs of the VRP were incurred in order to get employees to retire only three years earlier than they would have in the absence of the plan.

Mr. Opich also attempts to justify the three-year amortization by asserting that it is not correct to say that the actual disbursements of the VRP will carry out to ten years or more. To support this assertion, Mr. Opich notes that the acceleration of eligibility for benefits is less than ten years for most employees. However, this ignores the fact that the cost of the VRP relates not only to the acceleration of benefits but also to the enhancement of pension benefits for retiring employees (response to Data Request AG-4.4). There is no question that the actual disbursements associated with the enhancement of pension benefits will extend well beyond ten years.

Q. On Page 14 of his rebuttal testimony, Mr. Opich notes that you have not correctly calculated your adjustment to remove incentive compensation from the cost of service. What is your response?

A. Mr. Opich is correct. I should not have applied the wage increases to the incentive compensation. The correct adjustment to remove incentive compensation from the CIPS cost of service is $476,000. The correct adjustment to remove incentive compensation from the UE cost of service is $58,000.

Q. With regard to rate case costs, Mr. Opich defends the splitting of rate case expense equally on the grounds that the cost of a rate case does not vary materially depending on the size of the company. What is your response?

A. Although the cost may not vary materially based on the size of the company, the value of the rate cases to their investors certainly does. CIPS is seeking increased base rate revenues of $16,395,000, while UE is seeking increased base rate revenues of $3,969,000. It is not unreasonable for the allocation of rate case costs to reflect this disparity. In addition, in practical terms, with the allocation method proposed by Mr. Opich, the annual amortization of rate case costs represents approximately 1.5% of UE base rate revenues. This is not huge, but it is noticeable to customers. With rate case costs allocated based on the relative size of the two companies, the impact on UE customers is relatively modest, without imposing unreasonable costs on CIPS customers.

Q. What is your opinion of Mr. Opich's request that CIPS and UE should be allowed to include in future rate cases any unamortized balance related to rate case expenses if the Commission determines that a five-year amortization period is appropriate?

A. This is, in effect, a request to implement a retroactive, one-sided true-up mechanism. Mr. Opich is not volunteering to refund to customers any over-collection of rate case costs if its next rate change takes place after the amortization of rate case costs from this case is complete. The Commission should reject this request because it is one-sided and violates basic ratemaking and test year principles.

Q. Mr. Opich claims that your proposed adjustment to reduce outside services expense by $1,980,000 is unnecessary because the “proper level of outside professional services expenses was included in the original filings” on the C-1 Schedules. Has Mr. Opich provided any documentation that would support this assertion?

A. No. Data Request AG-4.5 asked CIPS to “provide documentation supporting the statement that the proper level of outside professional services expenses was included in the C-1 Schedules as originally filed.” Mr. Opich instead provided documentation supporting the level of outside professional services expenses included in the original response to Staff Data Request CIPS-063(f) and the revised response to Staff Data Request CIPS-063(f). There was no documentation whatsoever supporting the level of outside professional services expenses included in the C-1 Schedules as originally filed.

Q. Does the CIPS C-1 Schedule as originally filed include the proper level of outside professional services expenses?

A. No. The CIPS C-1 Schedule includes the level of outside professional services expenses as shown in the original response to Staff Data Request CIPS-063(f), the expense that CIPS has acknowledged is overstated by $1,980,000.

Q. Please explain how you determined that the CIPS C-1 Schedule includes outside professional services expenses that are overstated by $1,980,000.

A. The original response to Staff Data Request CIPS-063(f) shows $3,760,000 of outside services expense. CIPS subsequently acknowledged in the revised response to Staff Data Request CIPS-063(f) that the correct expense is $1,780,000. Thus, the amount of $3,760,000 in the original response to Staff Data Request CIPS-063(f) is overstated by $1,980,000. Referring to the response to Staff Data Request CIPS-008A, the overstated outside services expense of $3,760,000 (appearing as $3,759,830) is included in total non-payroll administrative and general expense ("A&G") of $10,782,000 (adding together the operation expense and the maintenance expense).

Referring to the response to Staff Data Request CIPS-005, the total payroll costs included in test year A&G before adjustments is $2,003,000. Adding the non-payroll A&G expense to the payroll expense, the total is $12,785,000. This amount appears on CIPS Schedule C-2, Column (C), Line 11. As there are no adjustments to remove the excess $1,980,000 of outside service expense from the A&G on Schedule C-2, the overstatement carries forward to Schedule C-1. Thus, contrary to Mr. Opich's claim, the proper level of outside professional services expenses was <u>not</u> included in the original filing on the C-1 Schedule. The operation and maintenance expense on both CIPS Schedule C-1 and Schedule C-2 must be reduced by $1,980,000 to correct the outside services expense included in the cost of service.

Q. Does UE Schedule C-1 include the $35,000 of excess outside services expense eliminated by Staff?

A. Yes. Going through the same exercise would establish that UE Schedules C-1 and C-2 include $128,000 of outside services expense, which is $35,000 in excess of the proper level of outside services expense as contained in the revised response to Staff Data Request UE-063(f). Staff's $35,000 adjustment to outside services expense is appropriate.

Q. On Page 19 of AmerenCIPS/UE Exhibit No. 14.0, Mr. Opich defends the use of the 2003 budget for pension and OPEB expense on the grounds that the 2003 budgeted amounts are "supported by a 2003 actuarial study." Is that characterization of the support for the 2003 budget for pension and OPEB expense accurate?

A. No. As acknowledged by the Companies in the supplemental response to CIPS&UE Attorney General Data Request 4.6, the budgeted 2003 pension and OPEB expenses were developed "using trends and forward looking conditions from the 2002 actuarial study, which was provided to both the Attorney General's office and the ICC Staff."

It is true that the 2002 actuarial studies were provided to both the Attorney General's office and the ICC Staff. In fact, I based my pro forma pension and OPEB expense on the 2002 actuarial studies. However, the Companies have not provided workpapers or calculations showing just how the "trends and forward looking conditions from the 2002 actuarial study" were used to develop the 2003 budgeted expenses. Given the lack of supporting documentation for the budgeted 2003 pension and OPEB expense, I continue to believe that my reliance on the 2002 actuarial studies to calculate the pro forma expenses is appropriate.

Q. Mr. Opich takes exception to the capitalization ratios that you used for pensions and OPEB, contending that you should have used "the actual rates supplied by the Companies." Why did you not use the "actual rates" to which Mr. Opich refers?

A. Based on responses to Attorney General data requests, "the actual rates supplied by the Companies" can be found on CIPS workpaper WPC-3.10t and UE workpaper WPC-3.10v. Those workpapers, which state that the indicated factors will be in effect for the second quarter of 2002, show the following capitalization ratios:

	CIPS	UE
Pensions	0.25%	2.52%
Employee Benefits	25.32%	26.12%

Given the proportion of labor costs capitalized, the capitalization ratios for pensions appeared to be unreasonably low. Therefore, I applied the capitalization ratio for total test year labor costs to both pensions and OPEB in calculating my proposed adjustments. The labor capitalization ratios in the test year were higher than the pension capitalization ratios but lower than the employee benefits capitalization ratios shown in the referenced workpapers. However, my proposed adjustments would have been larger, on balance, if I had used the capitalization ratios in the referenced workpapers.

Q. With regard to UE meter reading expenses, Mr. Opich states that your proposed adjustment fails to recognize that labor expense associated with this account has decreased. Does this change your opinion on whether an adjustment to meter reading expenses for the twelve months ended June 30, 2002 is appropriate?

A. No. The fact that labor expense has decreased does not affect the extraordinary nature of the expenses incurred during the test year. As described by the Company, these extraordinary expenses were incurred to effect a transition to a new billing system. Once the transition is complete it should no longer be necessary to incur the expenses necessary to effect the transition. I continue to believe that an adjustment to normalize meter reading expenses is appropriate.

Q. Mr. Opich states that you base your adjustment to UE customer records and collection expenses solely on the response to Data Request AG 3.18. Is that statement accurate?

A. No. As I explained in my direct testimony, I also compared the customer records and collection expenses for the twelve months ended June 30, 2002 to the expenses incurred in other recent years. Mr. Opich does not deny that the costs associated with training employees on the new customer service are non-recurring. Rather, he contends that ongoing costs associated with the new system will, in effect, supplant the costs of training the employees. However, he has offered no documentation supporting the costs associated with the new system, nor has he provided any comparison of those costs to the training costs. He has not established that a normalization of actual customer records and collection expenses incurred in the twelve months ended June 30, 2002 is unnecessary.

Q. Does this conclude your rebuttal testimony?

A. Yes.